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Federal Open Market Committee

Conference Call

December 7, 1990

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Boehne
Mr. Boykin
Mr. Hoskins
Mr. Kelley
Mr. LaWare
Mr. Mullins
Mr. Stern

Messrs. Black, Forrestal, and Keehn, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Prell, Economist

Messrs. Lindsey, Promisel, Siegman, Simpson, and Stockton, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account
Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Coyne, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Hendricks, Oltman, and Powell, First Vice Presidents, Federal Reserve Banks of Cleveland, New York, and San Francisco, respectively

Transcript of Federal Open Market Committee Conference Call of December 7, 1990

CHAIRMAN GREENSPAN. Good afternoon, everyone. The purpose of this meeting is to fill ourselves in on the views of the Committee, given that a number of events have occurred or will be occurring in the interim between the last meeting and the next scheduled one. So, I think it would be useful for us to be brought up to date. As you know, we eased policy a notch under the asymmetric directive this morning. It was clear that at some point some action would be warranted as the economy eased. The fed funds rate opening up this morning at 7-1/4 percent put us in the position today of either protesting the rate for the second day in a row or essentially acquiescing to it. We decided that it was more sensible to do the latter, especially in view of the fact that recently we have been getting a significant number of requests from the [Reserve] Banks for a discount rate cut. That issue will be on the agenda sometime next week for basic review.

I'd just like to run through quickly what I think is happening in the economy and then I'll call on Mike Prell to fill us in on today's employment report which, as I'm sure you all well know, came out a bit on the [down side] of expectations. I think it's fairly apparent that we are seeing a weakened retail market. And while I suspect that the sharp fall-off in automotive retail sales in the last 10 days of November is partly an aberration in the same sense that the normal strength earlier on was of dubious merit, nonetheless, I think the trend is clearly down. And there has been some fairly significant weakening in industrial activity in the month of November. However, it's difficult to make the case, at least as I see it, that this acceleration on the down side is continuing in the sense that the industrial production data that we have on a weekly basis, which comprise at least a moderate part of the total index, suggest that the last week in November is not significantly different from the average for the month. And initial claims for unemployment insurance, while in a higher plateau, are not accelerating much beyond the 450,000 range. One must remember that back in 1982 they were up to 650,000 to 700,000 weekly. Part of that, I suspect, is that there was greater participation in the unemployment insurance system back then. But even making whatever adjustments one would like, the degree of weakness in this economy, at least at the moment, is nowhere near the order of magnitude that one perceived in 1982. Obviously, the orders picture is somewhat weak, but the October orders figures were scarcely a set of numbers that one picks up in the middle or even the beginning of a recession. From what we can judge from the structure of the orders and other information, the predominant element of strength in the data was on the export side; domestic orders are really quite soft.

Now I would like to call on Mike Prell to give us a quick update on how he reads the employment situation. Then I would ask that Messrs. Cross and Sternlight bring us up to date. Then, finally, I would like to call on Don Kohn to report on the issue of the money supply, which continues to be on the soft side, and which is one of the more disturbing elements that I find in the financial picture. Mike.

MR. PRELL. Well, Mr. Chairman, the Committee members undoubtedly have the major figures, and you have covered the crux of the picture. We were surprised by the dimensions of the decline in private employment in November--270,000. There was a noticeable downward revision in the figures for September and October as well. The workweek, which we had noted last time had dropped more than we could possibly understand, did rebound, but only partially. So overall the hours of production workers for the current quarter are likely to be down very sharply.

CHAIRMAN GREENSPAN. [Unintelligible] in the fourth quarter?

MR. PRELL. In the fourth quarter [hours worked] are likely to be down very sharply, on the order of perhaps 5 percent at an annual rate. That combined with the other information we have on the labor market--the unemployment rate and so on--suggests to us that the decline in GNP this quarter is likely to be at least as large as the 2 percent that we had in the last Greenbook. We're trying to sort through the data and come up with a reasonable estimate as we work toward next Wednesday's Greenbook publication. My guess is that it will be closer to [a decline of] 3 percent when we're done with this. Industrial production, as the Chairman noted, appears to be down very sharply in November. It's a larger decline than the 3/4 of a percent that we saw in October, based on both the physical product indicators that we have and the hours in manufacturing for last month. So, those are the major inferences we have from the labor market.

CHAIRMAN GREENSPAN. I guess the only good news is that the average hourly earnings figures were extended.

MR. PRELL. Right. It was the second straight month of essentially no change, and over the last three months they were up at a modest rate--something between 1 and 2 percent annualized. So in retrospect, looking at the employment cost indexes for the third quarter, it appears that we have seen some moderation in wage inflation recently as the labor market has weakened. We're continuing to have this puzzle about labor force participation. It continues to be weaker than we would expect, even with the decline in labor demand, and of course, that raises some analytical problems. Basically, the overall picture is one that we're not surprised by, i.e., declines in employment in manufacturing, construction, and retail trade. But the declines were sharper [than we expected] and we're trying to assess why and what the carry-through is going to be into the future months.

CHAIRMAN GREENSPAN. Are there any questions for Mike? If not, Sam Cross, would you bring us up to date?

MR. CROSS. Mr. Chairman, for several weeks, up until the past couple of days, the dollar was finding pretty good support in the market, seemingly based on the continued Middle East tensions, the expressions of concern about a weak dollar from the Treasury and the Federal Reserve, talk of a G-7 meeting, some year-end activity, some of the uncertainties in Japan, some feeling that the dollar has fallen to a level where it is at a minimum very competitive, and also a view that the Fed's monetary moves have been quite measured. Yesterday and today the dollar eased off about 3 yen and 3 [pfennigs], reflecting unwinding of some of the [unintelligible]--not entirely, but a considerable amount--and a more negative view of the economy following the release of this morning's statistics and the implications of that for interest rates. Today, the dollar has not eased all that much; it may be that the dollar's decline has been kept in check partly by a spate of rumors this morning that the United States was intervening in the foreign exchange markets to support the dollar or perhaps a reluctance to take on new positions on a Friday afternoon. But we hear comments--including comments from our [unintelligible] committee, which happened to meet today--that a significant reassessment is now going on in the market and that many [market participants] feel that the downside potential for the dollar has increased. That's my report, Mr. Chairman.

CHAIRMAN GREENSPAN. Questions for Sam? If not, Peter Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman. As you know, right after the mid-November FOMC meeting we moved to lower the funds rate 1/4 percentage point from 7-3/4 to 7-1/2 percent. It took a few days to achieve that because of some other temporary pressures in the market, but the market got the point in a few days. Today, as was mentioned, another 1/4 point move was made, and that was rapidly [digested] by the market. Funds were trading at [7-1/4] percent at the time and we passed through some customer RPs. In fact, over the course of the day funds have drifted off a little further to 7-1/8 percent and there was even some trading at 7-1/16 percent just before I walked in for this call. Since mid-November Treasury bill rates have come down by 15 to 25 basis points, with maybe about half of that occurring today. Coupons are down even more [unintelligible], by 25 to 35 basis points; there too about half of it occurred today. Private sector rates have not come down as much; typically they lag. And a few short-term rates, such as those on 1-month CDs, actually have moved up a little because the time has come to bridge the year-end period and we are at the same time facing some concerns about year-end pressures. But those pressures themselves have come all in the last week. They seem to have reached a crescendo about the end of November and have abated noticeably since then. It's not that they couldn't swell up again, but at the moment they have abated.

Policy [has been seen] right along as having been in an easing mode, given the backdrop of weak news on the economy and soft aggregate numbers punctuated with what the market [digested] of the mid-November fed funds move and the reserve requirement reduction and then today's federal funds move. It seems to me that the easing has been seen in the market as well justified, and in that setting the longer-term rate has come down as I mentioned. The discount rate is getting some increased attention in the market; I'd say more and more people are looking for [a cut in] it. I wouldn't say a move has been entirely priced into market thinking, but to some extent a move in coming days has been priced into the thinking as of this point. As some of you may know, a few smaller banks--the Southwest Bank in St. Louis, another St. Louis bank, and then First Fidelity in New Jersey--have moved on the prime rate by 1/4 percentage point today. That's all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Questions for Peter? If not, Don Kohn.

MR. KOHN. As you noted, Mr. Chairman, the money stock is a little weaker than expected. Some past data have been revised upward but the November and very early December data look on the weak side. We are now projecting M2, partly estimated, at -3/4 percent for November. We had +1/2 percent in the Bluebook. For M3 for November we have -1 percent and we had +1/2 percent in the Bluebook. So, both of those are a bit weaker, at least in growth rate terms, in November. Some of that weakness and some of the outlook for further shortfalls rest on some very preliminary data for the week of December 3rd which show a sharp drop in M2 and also in M3. And because of that drop, even if we assume further growth for the month, we're looking at a weaker December at this point than we thought before and, therefore, shortfalls from the 3-month growth rates that the Committee was expecting. Right now we are projecting about 1/2 percent M2 growth for September-to-December, compared to 1-1/2 percent projected in the Bluebook, and about -3/4 percent M3 growth for September-to-December, compared to 0 in the Bluebook. So, it looks as if the aggregates aren't really responding to the easing of money market rates that has occurred over the last month.

We do have some very preliminary data on bank credit as well, and that shows for November another month of very sluggish growth--on the order of 1-1/2 to 2 percent--in bank credit. Loan growth picked up to an estimated 3 percent, but it is still very slow. Business loans did pick up--we're estimating 5 percent growth in business loans--but some of that appears to be replacing commercial paper that has run off or is being paid down by businesses that are finding the commercial paper market less hospitable or at least more expensive. If we add together commercial paper and business loans, we have no growth in the combined total of the two. So, the short-term credit picture for businesses remains very flat and very weak.

CHAIRMAN GREENSPAN. Questions for Don?

MR. MELZER. Don, what has M1 been doing and what do you expect it to do? And, are there possibly any distortions in those broader aggregates?

MR. KOHN. Actually, if there's a distortion in the broader aggregates, I think it's partly arising from M1. We got slightly greater growth in M1 in November than we expected but the weakness in this first week of December is in large measure a shortfall in demand deposits. Whereas we had projected a small increase, it looks as if there was about a $4 billion decline in the first week of December. I have to emphasize that this is a very preliminary number, but at this point we are looking at essentially no growth in M1 over the month of December, or maybe a small increase. The other factor here is that currency growth has slowed down in November. Unfortunately, we don't have data on foreign shipments of currency beyond October, so it's hard to know whether this is domestic or foreign caused. But we're looking at 4 percent currency growth in November after months of 10, 15, and 12 percent--double-digit growth rates, really, for all the [earlier months] of the year. But unfortunately we don't know the source of that. So, M1 seems to be slowing down a bit and a lot of that shortfall is in demand deposits.

MR. MELZER. Thank you.

MR. BOYKIN. Don, do you expect the change in reserve requirements to affect the money situation in any way?

MR. KOHN. Well, we're trying to sort that out, Bob. In one respect, we thought it might augment M3 a bit because there are some M3 components that will have lower taxes on them. But that's working against the higher deposit insurance premiums coming into effect, which I think will induce banks to move as much of their business as possible offshore, to the extent they can do that. And they can move their deposits to the Eurodollar market now and bring them back in an untaxed way from that market or they can make loans to U.S. customers over there without incurring reserve requirements. Because deposit insurance taxes are going up at the same time that the reserve requirement tax is going down, it's hard to say. It's something we're still trying to sort through.

MR. BOYKIN. Thank you.

CHAIRMAN GREENSPAN. Any other questions?

MR. SYRON. Dick Syron here. May I go back and ask Mike Prell a question?

CHAIRMAN GREENSPAN. Sure.

MR. SYRON. Mike, can I ask you to speculate--I guess that's the word--a little about the time lags on the impact or a range of impacts if, say, the Middle East situation were to be widely resolved or at least if there were a substantial diminution in warfare. If that were to happen by mid-January, what kind of impact would that have and what might one speculate about the time lags?

MR. PRELL. Well, President Syron, that is very speculative, obviously. There are two facets of this, one of which is even more difficult to assess than the other. One is the implication for oil prices. To the extent that the war premium comes out of oil prices, we would see a significant drop there and very quick translations--if we see the reversal of the earlier runup--through gasoline prices into overall consumer purchasing power. And we would expect that to have a fairly prompt influence on consumer spending. On the other hand, there is the war scare and what influence that has had on sentiment and what influence that in turn has had on actual spending, about which we know very little really. We have very shaky data on spending for October and only anecdotal evidence--apart from the chain store sales, which haven't proved very reliable in the past as a guide to overall spending--for November. My sense is that to understand why retail activity seems to have weakened as much as it has, one has to put some weight on the argument that sentiment has been adversely affected by the concerns about possible hostilities. And if people get to feeling a whole lot better about that, particularly around the Christmas season, perhaps one might see some catch-up on consumer spending. There are great uncertainties here, but my feeling is that if these things were to move in a positive direction, there could be some fairly prompt firming on the consumer side. But, as I said, that's very speculative.

CHAIRMAN GREENSPAN. Any further questions for anybody? It would be helpful at this point for any of the presidents or the governors whose view on the outlook, either within the District or the economy as a whole, has changed in any material way to put it on the table for discussion. I don't want to burden all of you by going around the whole [group], but if anyone has some new significant thoughts it would be useful to the rest of us to be exposed to them.

VICE CHAIRMAN CORRIGAN. Alan, this is Jerry. I agree with how you and Mike characterized the economy itself, but I do feel that even if that's right--and it probably is--the risks are asymmetric on [the down side]. I must say that the money supply and credit numbers and the lack of growth thereof now are an increasing concern.

CHAIRMAN GREENSPAN. A number of your colleagues here are shaking their heads.

VICE CHAIRMAN CORRIGAN. In which direction?

MR. KELLEY. Yes, yes.

CHAIRMAN GREENSPAN. Affirmatively. Would anyone else like to contribute something?

MR. MELZER. This is Tom Melzer. I might just quickly mention that we had earlier this week. a national home building operation, said that they were surprised by their November sales results, which were much better than they expected and about in line with those of a year ago and maybe a little better. So, he had the sense that things weren't continuing to deteriorate, which confirms something you said earlier. And who is involved with the trucking business felt the same way. His firm actually noticed a pickup in activity in the latter part of November. In terms of [the outlook], my view hasn't really changed. I have some concerns about the behavior of the aggregates too, but I'm not inclined to overreact to one month's figures. If you look at the thrust of monetary policy over a much longer time span, going back really to the first half of last year, I think the course of policy has been one that is generally consistent with expansion. I guess I'm saying that it wouldn't lead me to the conclusion that monetary policy is strangling the economy right now, and I don't think we can lose sight of the several [easing] steps that have been taken just recently.

CHAIRMAN GREENSPAN. I think that's right, Tom. I think that the really disturbing issue is not what the economy is doing, which is almost forecastable, but that the monetary aggregates are giving us wrong signals. I must say I'd feel a lot better personally with a slightly stronger M2. Does anyone have any sense of Christmas buying in the first week in December?

MR. SYRON. Mr. Chairman, this is Dick Syron. I talked to the managers of two of the main private stores in the area. I think their views are influenced largely by the extraordinarily pessimistic climate here but they went into the period expecting weak sales and [sales turned out] to be even softer than they had feared. And I think there is almost an edge of panic on their parts and the sense of other retailers--

MR. KEEHN. Mr. Chairman, this is Si Keehn in Chicago. I would echo what Dick is saying, though not in magnitude. I've talked to several retailers and they said that the Christmas season is starting off far weaker than even they expected. They do point out, though, that this is unusually long in their [unintelligible], and they are hopeful that as they get along toward Christmas it will pick up. The initial returns are quite bad.

MR. SYRON. Mr. Chairman, I might just put a technical note to that. The feeling here is that some of the sales [results] are due to the very warm weather we have had this season; that has had really a significant effect. And now we need [unintelligible] merchandise advertised in the beginning. Today some have spring merchandise, believe it or not, when it should be time just about for the coincidence of the first major snow.

CHAIRMAN GREENSPAN. As usual.

MR. BLACK. How's that going Dick?

MR. SYRON. Well, our oil spending is down!

CHAIRMAN GREENSPAN. Does anybody else have any insights, questions, thoughts, or notions?

MR. BLACK. Mr. Chairman, Bob Black. I do think we have to address this discount rate issue. I really [unintelligible] favor the penalty [rate] that Governor Angell has stated recently. But I do think this differential is now down so low that it is something that we need to look at and make a conscious decision about. Some of my colleagues may be surprised [unintelligible] because I've been very hawkish throughout my entire career, but it is out of line with past practices. It's very difficult to explain [to the directors] why this is so and we don't want to tell them it really doesn't play much of a role anymore unless we're going to give the changed expectation. So, we sent in a recommendation suggesting that the discount rate be lowered by 1/2 point, with an announcement that this was to bring it into alignment. I think a decision is needed on what sort of role we want the discount rate to play in the days ahead. I think we have the right amount of [ease] now and I wouldn't favor any further moves now, but I do think we need to look at that issue.

MR. KEEHN. This is Si Keehn. I agree with Bob. I think the structure of rates and the circumstances are such that it would be appropriate to change the discount rate. We have not changed it for some 22 months, which is an extraordinarily long period, despite all the changes that have taken place. And I think we should do that if for no other reason--and this is in itself [unintelligible]--than at least that the directors feel left out of the problem.

MR. GUFFEY. Mr. Chairman, Roger Guffey. I essentially agree with the last two speakers, with a bit of a twist, however. I would like to see an action taken today coupled with a discount rate move; if [the Board cut the discount rate] 1/2 point, I'd offset half of it through open market operations. That option is still open for the period ahead, it seems to me.

CHAIRMAN GREENSPAN. Well, Roger, we discussed precisely that this morning. The problem that we had today was one that the market confronted us with; it partially blocked our freedom of action. But I think we do have to consider--even though it's something we haven't done for quite a while--if we decide to move on the discount rate, whether we allow all of it to flow through to the funds rate.

MR. GUFFEY. Well, it would be my feeling that we shouldn't unless things deteriorate much further than they have at this point. I guess I still take some comfort from the fact that we are about on track in terms of where we want to be. And to start easing very aggressively as we did in 1976 I think would be inappropriate.

CHAIRMAN GREENSPAN. I don't think that--

MR. BOEHNE. This is Ed Boehne. As long as we're having a round robin on the discount rate, I think we have a discount rate cut in our future that's not too far down the road. However, I don't think we ought to do it in the next few days. While the economy is weak and while we do have concerns about the money supply, I think we have to be careful that we don't convey the notion that the Fed is really alarmed about the economy. If we lower reserve requirements on a Monday and then reduce the funds rate on a Friday and then on the following Monday or Tuesday cut the discount rate, it seems to me that that does convey a notion that maybe we think things are a lot worse than we want to indicate. While the underlying economy is soft, it's probably not as soft as the attitudes out there. So, I think we want to make certain that we ease into this announcement in a constructive way. Also, if and when we do cut the discount rate, I think we ought to let at least some of it flow through to the funds rate. Just to cut the discount rate for some kind of alignment reason or to make the record [unintelligible], I think would be even more confusing. And I would think we wouldn't want to cut the funds rate today and then cut it again two or three days from now. So, I just think we need a reasonable interval here before we hit the accelerator with something that will clearly have a major announcement effect.

MR. SYRON. Mr. Chairman, since we're in this general discussion, I guess one would take it that Sam thinks that the discount rate move would not have a major effect in the exchange markets at this point, that one quite [unintelligible]. The other issue, which I hate to raise again since it seems [heretical], is that I do think at some point that we are going to need to raise again this issue or at least the perception out there of the change. Be it real or not, it has been an [unintelligible]. Maybe I'm speaking too much from being close to some of the fire here, but until there is some change in perceptions I think we are going to have difficulty with the money supply.

MR. CROSS. Mr. Chairman, Sam Cross. May I just make clear what I was saying about this whole question? As I said earlier, I think one of the factors that has given the dollar some strength over recent weeks has been a perception that the monetary moves have been measured and understandable in light of the way the markets have moved and in light of the way the economy has moved. I think the [exchange] market is now going through a very searching kind of reassessment and they find themselves in new circumstances because of the Middle East situation and because of the worse-than-expected economic situation. Anything that conveyed any sense of panic on the part of the Fed would have the possibility of a very serious impact on the exchange market. Certainly, some of the people in that market are expecting a possible discount rate move at some point. But I wouldn't say that this is a move that could be made without any expectation of an impact on the exchange market.

MR. GUFFEY. Sam, do you have any sense of what the Japanese and Germans might do with their rate structures?

MR. CROSS. Well, not anything very formal or official or anything other than what the market is expecting. The situation with respect to the Japanese seems to have changed recently. Whereas earlier the general market view was that the Japanese would be tightening, that perception has turned around. With respect to the Germans, there is still an expectation of a possible--or some are even saying a probable--tightening perhaps as soon as next week when they have their meeting on Thursday the 13th, which is just prior to some EC meetings. Some people are saying that the Germans would want to move before then in order to position themselves for the EC. So, there's still a very substantial expectation that the Bundesbank may tighten further soon.

CHAIRMAN GREENSPAN. I'm off to Basle tomorrow and I'll get a much clearer picture from the group there as to what the latest feeling is and whether it is shifting. I have been getting calls here and there, but I think Sam has outlined as much as we know at the moment. If there are no further comments, I thank you very much.

END OF SESSION